

# **The Economic Outlook of Hong Kong in the Context of China's 12th Five-Year Plan**

## **A Speech by Dr Victor Fung to the Students and Professionals at Savantas Liberal Arts Academy 匯賢智庫學苑 on 21 May 2011**

Ladies and Gentlemen, Dear Students, I am honored to be able to talk to you today. I share the vision of Savantas Liberal Arts Academy which is “to transform Hong Kong into a world-class city based on knowledge, culture and creativity”. I believe it is one of the important directions for Hong Kong's future development.

The world's economic centre is shifting to Asia, a trend of increasing prominence after the financial tsunami. According to the estimation by IMF, contribution of developed economies to the world's GDP will decrease from 69% in 2007 to about 61% in 2015. The emerging economies, in particular China, are expected to be the driver of the world economy.

Under this worldwide trend, we must take note of the momentous development of China and its recent 12<sup>th</sup> Five-Year Plan. Therefore, I would like to focus my remarks today by looking at challenges and opportunities facing Hong Kong in the 12<sup>th</sup> Five-Year Plan period. I will also touch on the implications of the 12<sup>th</sup> Five-Year Plan for Hong Kong.

### **1. First let us look at the challenges facing Hong Kong**

- (a) Escalating competition within the services sector:** HK's economy is highly reliant on the services sector which accounts for 92% of total GDP. Among others, our financial, trading and logistics industries make up 50% of our GDP and 30% of our employment. However, these pillar industries are facing keener competition. For example, the Regional Plan for the Yangtze River Delta approved by the State Council in 2010 has set out three targets for Shanghai's strategic positioning, including a major international gateway to the Asia Pacific region, a global major centre of modern services and advanced

manufacturing industries and a world-class city cluster with enhanced international competitiveness. Meanwhile, Singapore is also endeavoring to strengthen its status as a financial centre in South-east Asia. These may bring considerable pressure to HK's financial services sector. Besides, with the implementation and furtherance of the Free Trade Agreement between the Mainland and the Association of South East Asian Nations (ASEAN), the finalization of Economic Co-operation Framework Agreement (ECFA) and the formation of Pearl River Delta port clusters, the traditional intermediary role of HK and its function as a bridge in the trade and economic spheres may be challenged.

**(b) Regional cooperation and competition will become the norm.** The global economic structure is changing, and regional competition has become a worldwide trend. Examples are many, like the establishment of the European Union and its development, the establishment of the China-ASEAN Free Trade Zone in 2010, the closer relationship among the three places across the Taiwan Strait, the rapid development of the Yangtze River Delta and coastal regions, and the strong progress of China's central and western regions. Foreseeably, regional cooperation and competition will become the norm, and it will be difficult for any individual city to compete on its own.

**2. So what can we do to face these challenges?** I believe the solution is a further economic integration with the Mainland of China. How can this be done? I must digress to talk about the Five-Year Plan of China.

#### **What is Five-Year Plan?**

- China has adopted a five-year planning cycle which formulates the development direction, strategies and indicators for economic and social development of China for the next five-year period.
- The first National Five-Year Plan was launched in 1953, covering the planning period from 1953 to 1957. Since then, the country has already implemented 11 National Five-Year Plans and will implement the National 12th Five-Year Plan from 2011 to 2015. Since the "opening-up" of China 30 years ago, we have seen consistent high growth in its economy. China is now the second largest economy in the World.

- The National Five-Year Plan can be classified at three planning levels: national, provincial/municipal and individual specific projects. The one at the national level attracts more public discussion. It is formally known as "The Outline of the Five-Year Plan for National Economic and Social Development of the People's Republic of China" 《中華人民共和國國民經濟和社會發展五年規劃綱要》 or, in brief, the "National Five-Year Plan" 《十二五規劃》.

### 3. Why does this concern Hong Kong?

We must now look at increasing economic integration of Hong Kong and the Mainland of China

- The ties between Hong Kong and the Mainland are getting closer. The Chinese Mainland and Hong Kong have been going through economic integration over the past 30 years since the opening up of the Mainland economy. The integration was heightened in 2003, when the Mainland and Hong Kong, being two separate customs territories under WTO, entered into a free trade agreement called "The Mainland and Hong Kong Closer Economic Partnership Arrangement" (CEPA) (《內地與香港關於建立更緊密經貿關係的安排》).
- The Mainland of China has increasingly contributed to the Hong Kong economy in various ways.

Four examples are sufficient to illustrate this point. (1) The Stock Exchange of Hong Kong has raised the largest amount of money (HK\$445bn) in the world during 2010. Most of the newly listed companies come from the Chinese Mainland or have substantial operations there. (2) Tourists from the Chinese Mainland are the highest spenders among all tourists visiting Hong Kong and there were 22.7M visitors from the Mainland during 2010 and increasing. (3) Hong Kong has the largest deposit base of RMB outside Mainland China (RMB400B at the end of 2010) and is the official off-shore RMB clearance centre. (4) In 2009, the Mainland was Hong Kong's largest domestic export market, absorbing HK\$26.7 billion (US\$3.4 billion) worth of goods, or 46.2% of our total domestic exports.

All in all, we are much influenced by the Mainland's economic development.

#### **4. So what is so important about this 12<sup>th</sup> Five-Year Plan?**

I would like to highlight 3 areas in this 12<sup>th</sup> Five-Year Plan (12-5 Year Plan):

**(a) Transforming the development pattern**

**(b) Putting people first**

**(c) A Chapter is dedicated to Hong Kong and Macau**

Now I go into some details of each area.

**(a) Transforming the development pattern**

##### Domestic demand as an engine of growth

- The 12-5 Year Plan states that domestic consumption is a key driver of growth in the future. This will be achieved by promoting urbanization actively and steadily reforming the income distribution system, improving the social security system and creating a favorable consumption environment.

##### Increasing contribution from the service sector

- China targets to increase the contribution of service sector to total GDP from 43% in 2010 to 47% in 2015. This will help China establish a mode of sustainable development under which consumption, investment and export contribute to economic growth in a balanced way.

##### Adjustment of the industrial structure

- The 12-5 Year Plan suggests that, instead of continuing with the development of low-cost, low-value-added industries, China should vigorously develop service and advanced manufacturing industries and strategic emerging industries. In addition, through technological innovation and upgrading, industries can enhance their core competitiveness.

## **(b) Putting people first**

### Improving people's livelihood

- The 12-5 Year Plan states that China should align urban and rural residents' income growth in pace with economic development and reduce the widening income gap between urban and rural areas. At the same time, equality of basic public services should be promoted so that the whole country can share the fruits of development. We begin to see some actions being taken in this area. The minimum wages have been drastically increased in most coastal areas.

### Building an environment-friendly society

- The 12-5 Year Plan also mentions that, while promoting economic development, particular attention should be paid to the environmental impact of development. With a view to building a resource-conserving and environment-friendly society, it proposes:
  - promoting energy conservation and emission reduction,
  - encouraging conservation and recycling of resources,
  - responding actively to global climate change, and
  - stepping up environmental and ecological protection,

## **(c) A Chapter is dedicated to Hong Kong and Macau**

It is a significant breakthrough that an individual chapter is dedicated to Hong Kong and Macau in the 12-5 Year Plan. The chapter clearly sets out, among other things, the Central Government's support for Hong Kong in the following three major areas:

- enhancing Hong Kong's status as an international centre for financial services, trade and shipping; and in particular, the support for Hong Kong's development as an offshore Renminbi centre and an international asset management centre;
- nurturing its six priority industries ( i.e. testing and certification, medical services, innovation and technology, cultural and creative industries, environmental industries and education services) where Hong Kong enjoys clear advantages; and

- deepening economic co-operation with Mainland and continuing to implement CEPA. The Plan also confirms the significant functions and positioning of Hong Kong's co-operation with Guangdong under the “Framework Agreement on Hong Kong/Guangdong Co-operation”, including:
  - the establishment of a financial co-operation zone and a world-class metropolitan cluster with Hong Kong's financial system taking the lead,
  - the support for Guangdong to open up its service industries to Hong Kong on a pilot basis and extending the pilot scheme to other regions gradually.

## **5. What are opportunities for Hong Kong?**

- (a) Capitalizing on the policies in the 12-5 Year Plan and opportunities arising from the rapid socio-economic development of China, Hong Kong can strengthen its four pillar industries (i.e. financial services, trading and logistics, producer and professional services, and tourism) and explore business opportunities for the six priority industries (i.e. testing and certification, medical services, innovation and technology, cultural and creative industries, environmental industries and education services);
- (b) Fully leverage the strengths of Hong Kong (e.g. robust service sectors, strategic location, well-established international networks, sound legal system and high standard of corporate governance etc) to serve the Mainland market: HK has exported services to the Mainland, such as MTR and the Airport Authority. I am going to give you an example which I am familiar with as I was involved in it as Chairman of the Hong Kong Airport Authority. In October 2006, the Airport Authority of Hong Kong and Zhuhai Municipal People's Government jointly financed the setting up of the HK-Zhuhai Airport Management Company Limited, which solely operates the Zhuhai Airport in form of trusteeship. Over the past three years, the Zhuhai Airport has been increasingly capable in facilitating people and cargo flows as well as the development of aviation industry, and its management and service standards are widely recognized by the community. The joint venture of Zhuhai Airport is a

successful case of leveraging the strengths of HK's services sector and business management in the PRD;

- (c) Consolidate HK's roles as a regional headquarter for multinational enterprises in Asia; meanwhile, continue to improve Hong Kong as an international metropolitan city, serving as a gateway for foreign enterprises to enter China; indeed, Hong Kong is the largest provider of foreign direct investment into the Mainland China. About 51% of China's foreign direct investment is originated from Hong Kong, reaching US\$46.1 billion in 2009. About 63% of China's overseas direct investment is also conducted through Hong Kong, reaching US\$35.6 billion in 2009. Also, as at 1 June 2009, there were 96 companies from the Mainland with regional headquarters in Hong Kong. Another 127 companies had set up regional offices in Hong Kong to oversee business activities in the region;
- (d) As a chairman of the Greater Pearl River Delta Business Council, I want to take this opportunity to share with you my observations from a regional perspective.

HK's future development is closely interwoven with the Pearl River Delta. Hong Kong and Guangdong have great potential to develop into a colossal hub of human resources, goods, capital and information flows, provided that the two places can remove any barriers that obstruct the free flows.

### **Key roles of Hong Kong and Guangdong**

**(1) Making use of the “Early and Pilot Implementation” (先行先試) arrangements, Hong Kong and Guangdong can continue to serve as a testing field for deepening the reforms of the country.**

- Testing field for financial reform: Hong Kong and Guangdong can serve as a testing ground for the Mainland in its gradual liberalization of the capital account and RMB internationalization;
- Promoting the development of services industries: Removing obstacles that are hampering Hong Kong's

services industries in entering the Mainland market, including the lack of mutual recognition of professional qualifications, high market entry thresholds and complicated approval procedures;

- Refining the existing policies for facilitating transition from export to domestic sales through Hong Kong-Guangdong co-operation;
- Hong Kong and Guangdong can contribute to the national education reform by relaxing the restrictions on establishing educational institutions, optimizing the mechanism for exchanges and enhancing training collaboration;
- The Framework Agreement on Hong Kong/Guangdong Co-operation has positioned Qianhai in Shenzhen, river loop area of Shenzhen and Nansha in Guangzhou as major co-operative regions of Hong Kong/Guangdong. I believe that different sectors of society should be actively engaged in exploring the room for development in these regions.

**(2) Hong Kong and Guangdong should fully leverage their respective strengths in service industries and manufacturing industries.**

- A target has been put forward for PRD of increasing the share of its services industries in the regional GDP from about 47.3% in 2008 to over 60% by 2020.
- HK should give full play to its strengths in professional services industries (including legal, financial, accounting and insurance services, etc.) to provide production-oriented services to PRD enterprises, assisting them in their upgrading and restructuring as well as their entry into the domestic market.
- Guangdong is not only a sourcing base but also a huge consumer market. Hong Kong companies which have rich experience in wholesaling and distribution of products in the United States and Europe stand a good chance in extending their wholesaling and distribution networks to Guangdong.

## 6. Conclusion

Hong Kong has always been an open economy, serving as a transportation, trading and communication hub of Asia. As an international gateway, it is closely integrated with other parts of the world. Through competing and co-operating with other nations, Hong Kong continues to improve, and innovate. However Hong Kong is a part of China and China has experienced significant growth which has already brought benefit to Hong Kong. Therefore we need to keep abreast of the latest development on the Mainland.

Having said all this, let us not lose sight of the fact that Hong Kong's competitiveness has always been its openness and international outlook, a bridge between East and West. So we should always widen our horizon, keeping abreast of the developments in **both** China and the World. Thank you.